

**Report of the
PUBLIC EMPLOYEE RETIREMENT
ADMINISTRATION COMMISSION
on the Examination of the
Melrose
Contributory Retirement System
For the Four Year Period
January 1, 1999 - December 31, 2002
PERAC 02: 09-059-26**

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May 21, 2004

The Public Employee Retirement Administration Commission has completed an examination of the Melrose Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 1999 to December 31, 2002. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in this report.

In our opinion, the financial records and management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission with the exception of those noted in the findings presented in this report.

In closing, I acknowledge the work of examiner James Sweeney who conducted this examination and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,

Joseph E. Connarton
Executive Director

Melrose Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

1. Annual Statement

Based upon inspection of the Annual Statements filed by the Board for the four year audit period, it was determined that certain line item amounts contained in the Annual Statement did not match the detailed supporting schedules. Variances were found in investment income, and realized and unrealized gains and losses. All cash accounts were not listed in Schedule 1. The Annual Statement does balance to the general ledger.

The Membership Supplemental Schedule total accumulated deduction does not balance to the general ledger or Annual Statements for 2002. An inactive member's deductions were transferred to the Pension Fund but not recorded in the general ledger.

Recommendation:

As a sole source of information to third parties, the Annual Statement and supporting schedules must be in agreement allowing readers to make an accurate assessment of the system's financial condition without having to reference the general ledger. Prior to submission of the Annual Statement, a review process should be established to ensure all entries on the Annual Statement agree with the detailed supporting schedules using the PERAC Annual Statement Guide published each year. Differences in custodian-provided schedules should be corrected, if needed, and reconciled to the general ledger prior to submission of the Annual Statement. All cash accounts must be listed on Schedule 1.

The Membership Supplemental Schedule must balance to the Annual Statement and general ledger. A correcting journal entry will be made during the 2003 accounting close to balance the schedule, Annual Statement and general ledger.

2. Reconciliation of Cash Accounts

The Melrose Retirement System has two bank checking accounts. There is no general ledger account number set up for the retiree's payroll checking account.

The Board is not receiving a copy of the cash reconciliation from the Treasurer.

Recommendation:

The Melrose Retirement System must set up a new general ledger account number for the retiree payroll account. The Board must receive monthly cash reconciliations from the Treasurer for both checking accounts. The adjusted bank balance must be balanced to the general ledger. The reconciliation must contain a list of outstanding checks. The Board must research any check not cleared within six months, so that the proper voiding and recording of these items can be completed.

Melrose Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

3. Expenses Paid

Some travel vouchers for conference hotel charges were not supported by detailed receipts.

A Board member received a duplicate payment for airfare to an investment conference.

Recommendation:

The Board must ensure that all vouchers contain detailed invoices before approving payment. Hotel folios are necessary to verify dates and validity of the expenses.

The Board member must immediately refund the overpayment to the System.

4. Refunds

The auditor reviewed refunds taken in each of the four years audited. The department head is not completing Section B of the Application for Withdrawal of Accumulated Total Deductions. Therefore, there is no confirmation as to whether the member resigned voluntarily or was terminated involuntarily. This data is critical when determining the amount of interest to be refunded.

Recommendation:

The Board must ensure that the department head completes Section B and properly indicates whether the termination was voluntary or involuntary.

5. Review of Minutes and Board Member Attendance

The Auditor reviewed Board Meeting Minutes from January 1999 through December 2003. One member was absent 41% in 1999, 33% in 2000 and 25% in 2001. This member's attendance has improved in subsequent years. The Ex-Officio serving in 2001 was absent for 41% of the Board meetings, and the subsequent Ex-Officio member serving in 2003 was absent for 41% of the Board meetings.

The Board stopped using pre-numbered pages in November 1999.

Recommendation:

Attendance at Board meetings is an obligation that must be fulfilled by all Board members. It is the Board's responsibility to advise members who fail to uphold their fiduciary duties to the System, and to take appropriate action with such members, when necessary. The Board may want to consider changing the time of Board meetings in order to accommodate its members.

In accordance with G.L. c.32, § 21(1) and Division of Insurance memo dated February 25, 1981 the pages of the Minutes must be pre-numbered or initialed by Board members. Pages intentionally left blank should be marked "intentionally left blank". It is also recommended that the Minutes be periodically bound.

Melrose Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

Board Response:

At the Retirement Board meeting on April 30, 2004 the findings of the condition of the retirement system were discussed. The Board found the findings to be fair and, due to changing of staff and procedural functions not passed on to current staff, feel that with the implementation of the recommendations the retirement system can continue at the standard that is required. The Board and staff members have already begun to correct the findings of the audit report.

Final Determination

PERAC audit staff will follow-up in six (6) months to ensure appropriate actions have been taken regarding all audit findings.

Melrose Retirement System

STATEMENT OF LEDGER ASSETS AND LIABILITIES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 1999
AND ENDING DECEMBER 31, 2002**

FOR THE PERIOD ENDING DECEMBER 31,				
ASSETS	2002	2001	2000	1999
Cash	\$3,763,284	\$3,613,090	\$4,248,087	\$4,193,807
Short Term Investments	0	0	0	0
Fixed Income Securities (at book value)	13,173,091	11,548,939	11,394,918	17,405,558
Equities	5,904,251	7,405,830	7,531,600	7,077,861
Pooled Short Term Funds	0	0	0	0
Pooled Domestic Equity Funds	3,454,736	4,781,119	6,384,000	0
Pooled International Equity Funds	2,247,760	2,841,747	3,214,849	12,337,234
Pooled Global Equity Funds	2,548,239	2,949,630	3,358,530	3,530,659
Pooled Domestic Fixed Income Funds	0	0	0	0
Pooled International Fixed Income Funds	0	0	0	0
Pooled Global Fixed Income Funds	0	0	0	0
Pooled Alternative Investment Funds	316,607	586,031	0	0
Pooled Real Estate Funds	2,310,492	2,175,466	1,986,440	518,014
Pooled Domestic Balanced Funds	9,315,207	9,544,582	9,188,483	110,688
Pooled International Balanced Funds	0	0	0	0
PRIT Cash Fund	0	0	0	0
PRIT Core Fund	0	0	0	0
Interest Due and Accrued	173,018	127,481	167,047	183,455
Accounts Receivable	2,602	2,681	0	0
Accounts Payable	0	0	0	0
TOTAL	<u>\$43,209,287</u>	<u>\$45,576,597</u>	<u>\$47,473,954</u>	<u>\$45,357,277</u>
FUND BALANCES				
Annuity Savings Fund	\$10,639,242	\$11,449,368	\$11,038,269	\$10,460,292
Annuity Reserve Fund	6,603,970	5,101,314	4,792,838	4,432,900
Pension Fund	8,102,426	8,380,758	8,677,427	8,798,403
Military Service Fund	1,644	1,546	1,517	1,486
Expense Fund	0	0	0	0
Pension Reserve Fund	17,862,005	20,643,611	22,963,902	21,664,196
TOTAL	<u>\$43,209,288</u>	<u>\$45,576,597</u>	<u>\$47,473,954</u>	<u>\$45,357,277</u>

Melrose Retirement System

STATEMENT OF CHANGES IN FUND BALANCES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 1999
AND ENDING DECEMBER 31, 2002**

	Annuity Savings Fund	Annuity Reserve Fund	Pension Fund	Military Service Fund	Expense Fund	Pension Reserve Fund	Total All Funds
Beginning Balance (1999)	\$9,758,089	\$4,381,514	\$8,662,257	\$1,454	\$0	\$19,013,817	\$41,817,132
Receipts	1298384	112952	3653243	32	297530	2650379	8012521
Interfund Transfers	(488049)	488049	0	0	0	0	0
Disbursements	(108133)	(549614)	(3517098)	0	(297530)	0	(4472375)
Ending Balance (1999)	10460292	4432900	8798403	1486	0	21664196	45357277
Receipts	1467055	138673	3706110	31	298136	1306604	6916609
Interfund Transfers	(811352)	811404	6847	0	0	(6898)	(0)
Disbursements	(77725)	(590138)	(3833932)	0	(298136)	0	(4799932)
Ending Balance (2000)	11038269	4792838	8677427	1517	0	22963902	47473954
Receipts	1516205	146628	3717375	29	309253	(2320291)	3369198
Interfund Transfers	(793922)	794106	(184)	0	0	0	(0)
Disbursements	(311185)	(632258)	(4013860)	0	(309253)	0	(5266555)
Ending Balance (2001)	11449368	5101314	8380758	1546	0	20643611	45576597
Receipts	1462613	159781	4133243	98	330897	(2781606)	3305026
Interfund Transfers	(2026797)	2026797	0	0	0	0	0
Disbursements	(245942)	(683922)	(4411575)	0	(330897)	0	(5672335)
Ending Balance (2002)	<u>\$10,639,242</u>	<u>\$6,603,970</u>	<u>\$8,102,426</u>	<u>\$1,644</u>	<u>\$0</u>	<u>\$17,862,005</u>	<u>\$43,209,288</u>

Melrose Retirement System

STATEMENT OF INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 1999
AND ENDING DECEMBER 31, 2002**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2002	2001	2000	1999
Annuity Savings Fund:				
Members Deductions	\$1,157,384	\$1,174,366	\$1,121,479	\$1,000,972
Transfers from other Systems	82,228	93,094	112,350	54,451
Member Make Up Payments and Redeposits	75,391	49,691	23,902	32,985
Investment Income Credited to Member Accounts	<u>147,610</u>	<u>199,054</u>	<u>209,325</u>	<u>209,975</u>
Sub Total	<u>1,462,613</u>	<u>1,516,205</u>	<u>1,467,055</u>	<u>1,298,384</u>
Annuity Reserve Fund:				
Investment Income Credited Annuity Reserve Fund	<u>159,781</u>	<u>146,628</u>	<u>138,673</u>	<u>112,952</u>
Pension Fund:				
3 (8) (c) Reimbursements from Other Systems	46,856	51,522	41,296	33,501
Received from Commonwealth for COLA and Survivor Benefits	420,425	154,724	304,173	378,847
Pension Fund Appropriation	<u>3,665,962</u>	<u>3,511,128</u>	<u>3,367,676</u>	<u>3,240,895</u>
Sub Total	<u>4,133,243</u>	<u>3,717,375</u>	<u>3,706,110</u>	<u>3,653,243</u>
Military Service Fund:				
Contribution Received from Municipality on Account of Military Service	0	0	0	0
Investment Income Credited Military Service Fund	<u>98</u>	<u>29</u>	<u>31</u>	<u>32</u>
Sub Total	<u>\$98</u>	<u>\$29</u>	<u>\$31</u>	<u>\$32</u>
Expense Fund:				
Expense Fund Appropriation	0	0	0	0
Investment Income Credited to Expense Fund	<u>330,897</u>	<u>309,253</u>	<u>298,136</u>	<u>297,530</u>
Sub Total	<u>330,897</u>	<u>309,253</u>	<u>298,136</u>	<u>297,530</u>
Pension Reserve Fund:				
Federal Grant Reimbursement	0	0	0	0
Pension Reserve Appropriation	0	0	0	0
Interest Not Refunded	797	1,383	769	1,263
Excess Investment Income	<u>(278,240)</u>	<u>(232,167)</u>	<u>130,583</u>	<u>264,916</u>
Sub Total	<u>(2,781,606)</u>	<u>(2,320,291)</u>	<u>1,306,604</u>	<u>2,650,379</u>
TOTAL RECEIPTS	<u>\$3,305,026</u>	<u>\$3,369,198</u>	<u>\$6,916,609</u>	<u>\$8,012,521</u>

Melrose Retirement System

STATEMENT OF DISBURSEMENTS

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 1999
AND ENDING DECEMBER 31, 2002**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2002	2001	2000	1999
Annuity Savings Fund:				
Refunds to Members	\$57,277	\$75,866	\$51,454	\$79,007
Transfers to other Systems	<u>188,666</u>	<u>235,319</u>	<u>26,271</u>	<u>29,125</u>
Sub Total	<u>245,942</u>	<u>311,185</u>	<u>77,725</u>	<u>108,133</u>
Annuity Reserve Fund:				
Annuities Paid	683,922	628,828	584,217	549,614
Option B Refunds	<u>0</u>	<u>3,429</u>	<u>5,921</u>	<u>0</u>
Sub Total	<u>683,922</u>	<u>632,258</u>	<u>590,138</u>	<u>549,614</u>
Pension Fund:				
Pensions Paid				
Regular Pension Payments	3,095,286	2,794,186	2,661,603	2,397,883
Survivorship Payments	292,728	277,881	256,648	238,165
Ordinary Disability Payments	126,690	111,275	73,424	134,834
Accidental Disability Payments	618,896	590,154	610,545	534,805
Accidental Death Payments	179,538	148,602	146,054	137,053
Section 101 Benefits	33,342	32,459	32,558	23,368
3 (8) (c) Reimbursements to Other Systems	65,094	59,303	53,238	50,992
State Reimbursable COLA's Paid	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Chapter 389 Beneficiary Increase Paid	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>4,411,575</u>	<u>4,013,860</u>	<u>3,833,932</u>	<u>3,517,098</u>
Military Service Fund:				
Return to Municipality for Members Who Withdrew Their Funds	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Expense Fund:				
Board Member Stipend	21,331	19,500	19,500	19,474
Salaries	108,384	95,383	87,614	83,766
Legal Expenses	0	2,121	0	0
Medical Expenses	214	0	0	0
Travel Expenses	13,204	14,231	12,725	972
Administrative Expenses	16,495	9,060	6,512	13,677
Furniture and Equipment	2,207	0	0	0
Management Fees	146,062	147,129	65,142	36,477
Custodial Fees	0	-920	90,392	137,915
Consultant Fees	<u>23,000</u>	<u>22,750</u>	<u>16,250</u>	<u>5,250</u>
Sub Total	<u>330,897</u>	<u>309,253</u>	<u>298,136</u>	<u>297,530</u>
TOTAL DISBURSEMENTS	<u>\$5,672,335</u>	<u>\$5,266,555</u>	<u>\$4,799,932</u>	<u>\$4,472,375</u>

Melrose Retirement System

INVESTMENT INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 1999
AND ENDING DECEMBER 31, 2002**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2002	2001	2000	1999
Investment Income Received From:				
Cash	\$37,247	\$109,472	\$93,412	\$119,954
Short Term Investments	0	0	0	0
Fixed Income	349,441	809,165	1,210,120	1,104,623
Equities	139,150	140,433	174,006	202,396
Pooled or Mutual Funds	<u>16,007</u>	<u>638,565</u>	<u>547,807</u>	<u>164,724</u>
Commission Recapture	<u>2,002</u>	<u>3,230</u>	<u>0</u>	<u>3,930</u>
TOTAL INVESTMENT INCOME	<u>543,847</u>	<u>1,700,864</u>	<u>2,025,345</u>	<u>1,595,626</u>
Plus:				
Increase in Amortization of Fixed Income Securities	-	-	-	125,323
Realized Gains	145,015	481,187	837,675	2,852,542
Unrealized Gains	6,666,129	4,284,077	4,842,765	1,858,991
Interest Due and Accrued on Fixed Income Securities - Current Year	<u>173,018</u>	<u>127,481</u>	<u>167,047</u>	<u>183,455</u>
Sub Total	<u>6,984,162</u>	<u>4,892,745</u>	<u>5,847,487</u>	<u>5,020,312</u>
Less:				
Decrease in Amortization of Fixed Income Securities	-	-	-	(499,657)
Paid Accrued Interest on Fixed Income Securities	7,257	(58,296)	(21,481)	(109,824)
Realized Loss	(259,143)	(497,847)	(285,871)	(1,357,666)
Unrealized Loss	(10,076,958)	(7,802,900)	(6,226,688)	(1,167,577)
Custodial Fees Paid	-	-	-	-
Consultant Fees Paid	-	-	-	-
Management Fees Paid	-	-	-	-
Board Member Stipend	-	-	-	-
Interest Due and Accrued on Fixed Income Securities - Prior Year	<u>(127,481)</u>	<u>(167,047)</u>	<u>(183,455)</u>	<u>(211,607)</u>
Sub Total	<u>(10,456,324)</u>	<u>(8,526,090)</u>	<u>(6,717,495)</u>	<u>(3,346,332)</u>
NET INVESTMENT INCOME	<u>(2,928,315)</u>	<u>(1,932,481)</u>	<u>1,155,337</u>	<u>3,269,606</u>
Income Required:				
Annuity Savings Fund	147,610	199,054	209,325	209,975
Annuity Reserve Fund	159,781	146,628	138,673	112,952
Military Service Fund	98	29	31	32
Expense Fund	<u>330,897</u>	<u>309,253</u>	<u>298,136</u>	<u>297,530</u>
TOTAL INCOME REQUIRED	<u>638,387</u>	<u>654,964</u>	<u>646,165</u>	<u>620,490</u>
Net Investment Income	<u>(2928315.14)</u>	<u>(1932481.29)</u>	<u>1,155,337</u>	<u>3,269,606</u>
Less: Total Income Required	<u>638387</u>	<u>654964</u>	<u>646165</u>	<u>620490</u>
EXCESS INCOME TO THE PENSION RESERVE FUND	<u>(\$3,566,702)</u>	<u>(\$2,587,446)</u>	<u>\$509,172</u>	<u>\$2,649,116</u>

Melrose Retirement System

STATEMENT OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

	MARKET VALUE	PERCENTAGE OF TOTAL ASSETS	PERCENTAGE ALLOWED*
Cash	\$3,763,284	8.74%	100
Short Term	0	0.00%	100
Fixed Income	13,173,092	30.61%	40 - 80
Equities	5,904,251	13.72%	55
Pooled Short Term Funds		0.00%	
Pooled Domestic Equity Funds	3,454,736	8.03%	
Pooled International Equity Funds	2,247,760	5.22%	15
Pooled Global Equity Funds	2,548,239	5.92%	
Pooled Alternative Investment Funds	316,607	0.74%	
Pooled Real Estate Funds	2,310,492	5.37%	5
Pooled Domestic Balanced Funds	9,315,207	21.65%	
GRAND TOTALS	<u>\$43,033,668</u>	<u>100.00%</u>	

* The book value differs from the market value for individually owned Fixed Income Securities which are valued at amortized cost which is the original cost of the investment plus or minus any bond discount or bond premium calculated ratably to maturity. All other investments are reflected at their quoted market value.

For the year ending December 31, 2002, the rate of return for the investments of the Melrose Retirement System was -5.67%. For the five year period ending December 31, 2002, the rate of return for the investments of the Melrose Retirement System averaged 3.47%. For the 18-year period ending December 31, 2002, since PERAC began evaluating the returns of the retirement systems, the rate of return of the investments of the Melrose Retirement System was 9.31%.

Melrose Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

The Melrose Retirement System submitted the following supplementary investment regulations, which were approved by PERAC on :

July 27, 1989

(1) Real estate investments shall not exceed 5% of the total book value of the portfolio provided that:

(a) trust participants or limited partners do not participate in the selection of trustees or general partners and should a trust participant or limited partner be required to participate in the selection of a trustee or general partner, prior to any participation by the board, the board shall consult with PERAC to determine the appropriate course of action, and

(b) such trustees or general partners retain authority in the decision making process and

(c) should an investment in a trust or limited partnership result in the direct ownership of real estate or mortgage indebtedness, such shall be permitted only until such time as divestiture of said trust or limited partnership is prudent.

September 3, 1997

Equity investments shall not exceed 55% of the portfolio valued at market, including international equities which shall not exceed 15% of the portfolio valued at market.

July 10, 2001

16.08

1. Exemption of the Board and INVESCO from the second sentence of 840 CMR 17.04(1)(c) – This Regulation deals with the use of non-public information by managers and consultants. PERAC recognizes that, in making the investments contemplated by the INVESCO Funds delineated above, that sentence, which prohibits action until information is publicly disseminated, represents an undue burden on the ability of the Partnerships to operate. Consequently, the Melrose Retirement Board's request as it applies to 840 CMR 17.04(1)(c) is approved.

2. Exemption of the Board and INVESCO from 840 CMR 17.04(6), except as otherwise provided for in the Partnership Agreement and/or as disclosed in INVESCO's Form ADV. This Regulation deals with the Priority of Transactions and an investment manager's obligation to prioritize board transactions and provide the board with the opportunity to act prior to the manager acting, if applicable. PERAC recognizes that this Regulation may impede the ability of partnerships such as INVESCO's to operate. Upon receipt of a copy of the provisions of the Partnership Agreement and/or disclosures in the INVESCO Form ADV, the Commission will approve the Melrose Retirement Board's request as it applies to 840 CMR 17.04(6).

3. Exemption of the Board and INVESCO from 840 CMR 19.01(7)(a)(6) with respect to the management fees and the General Partner's Carried Interest to be received by the manager or the General Partner pursuant to the (a) Subscription Agreement, (b) Agreement as defined in the side letter, and/or (c)

Manager's Investment Advisory Agreement with respect to the Board's commitments to the Partnerships – PERAC recognizes the fact that the market, at the present time, is such that fee limitations, as outlined in these Regulations, result in limiting the number of partnerships available

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

to the retirement boards. Consequently, the Melrose Retirement Board's request, as it applies to 840 CMR 19.01(7)(a)(6), is approved.

4. Exemption of the Board and INVESCO from 840 CMR 21.01(2), 21.01(3)(a), 21.01(4), and 21.01(5) to the extent as otherwise permitted under the applicable agreement – These Regulations prohibit certain transactions as follows: 21.01(2) prohibits the sale of securities not owned by the system at the time of the sale (short sales); 21.01(3)(a) permits the use of forward currency contracts in limited circumstances; 21.01(4) prohibits the use of call options; 21.01(5) prohibits the purchase of options other than as required to close out option positions. PERAC has received a letter dated August 22, 2000 from INVESCO that clarifies the possible use of options, futures, or other derivatives. In pertinent part, the letter states as follows:

“Although the above referenced funds do not expect to use options, futures, or other derivatives other than infrequently, if at all, futures and/or options would be used only for nonspeculative true hedging purposes. In general, we would anticipate their use, if at all, for among other reasons to protect downside risk on public securities of companies distributed to the funds by the underlying portfolio funds we invest in and where a commitment to a fund was made in a non US currency to limit currency risk of the funds.”

PERAC approves the exemption of the Board and INVESCO from 840 CMR 21.01(2), 21.01(3)(a), 21.01(4), and 21.01(5) for the limited purpose of protecting downside risk on public securities of companies distributed to the funds by underlying portfolio funds and to limit currency risk of the funds where a commitment to a fund was made in a non US

currency. Please be advised that this Supplemental Regulation as it exempts the Melrose Retirement Board from PERAC Regulations, only does so in relation to the INVESCO

Funds that are the subject of the Supplementary Regulation. In all other circumstances, these Regulations apply to the Melrose Retirement Board. The Supplementary Regulations approved herein are applicable only to the Melrose Retirement System's

investment in the INVESCO Venture Partnership Fund III, L.P. Exemption from the regulations pertaining to prohibited investments is limited to the purpose of protecting downside risk on public securities of companies distributed to the funds by underlying portfolio funds and to limiting currency risk of the funds where a commitment to a fund was made in a non-U.S. currency.

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

NOTE 1 - THE SYSTEM

The plan is a contributory defined benefit plan covering all Melrose Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

Instituted in 1937, the System is a member of the Massachusetts Contributory Retirement System and is governed by Chapter 32 of the Massachusetts General Laws. Membership in the plan is mandatory immediately upon the commencement of employment for all permanent, full-time employees.

The system provides for retirement allowance benefits up to a maximum of 80% of a member's highest three year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, level of compensation, and group classification.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65 (for certain hazardous duty and public safety positions, normal retirement is at age 55).

A retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of the interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. The average retirement benefit is approximately 75 - 85% pension and 15 - 25% annuity.

Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Members joining the retirement system after January 1, 1979 must contribute an additional 2% on regular compensation earned at a rate in excess of \$30,000. The percentage rate is keyed to the date upon which an employee's membership commences. These deductions are deposited in the Annuity Savings Fund and earn interest at a rate determined by the Executive Director of PERAC according to statute. When a member's retirement becomes effective, his/her deductions and related interest are transferred to the Annuity Reserve Fund. Any cost-of-living adjustment granted between 1981 and 1997 and any increase in other benefits imposed by state law during that period are borne by the state.

The pension portion of any retirement benefit is paid from the Pension Fund of the System. The governmental unit employing the member must annually appropriate and contribute the amount of current year pension payments as indicated on the most recent funding schedule as approved by PERAC's Actuary. Until recently, retirement systems were paying only the actual retirement

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

benefits that were due each year. Systems had no statutory authorization to put aside any money for the future benefits of employees who are now working. Large unfunded liabilities resulted from operating upon this pay-as-you-go basis. In 1977, legislation authorized local governments to appropriate funds to meet future pension obligations.

In 1983, additional legislation was passed requiring the transfer of investment earnings (in excess of the amount credited to member accounts) into the Pension Reserve Fund. These initiatives have significantly reduced the rate of growth of the retirement systems' unfunded liabilities, and in some systems have actually eliminated such liability.

Administrative expenses are funded through investment income of the system.

Members who become permanently and totally disabled for further duty may be eligible to receive a disability retirement allowance. The amount of benefits to be received in such cases is dependent upon several factors including: whether or not the disability is work related, the member's age, years of creditable service, level of compensation, veteran's status, and group classification.

Employees who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total deductions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive either zero (0%) percent, fifty (50%) percent, or one hundred (100%) percent of the regular interest which has accrued upon those deductions. Survivor benefits are extended to eligible beneficiaries of members whose death occurs prior to or following retirement.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Executive Director of Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Voluntary contributions, redeposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

The Melrose Retirement System submitted the following supplementary membership regulations, which were approved by PERAC on:

July 1, 1985

Eligibility:

Employees working less than twenty (20) hours per week are ineligible for membership.

Regular Part-time Personnel:

Permanent employees working for at least twenty (20) hours per week and less than 35 shall be granted creditable service promoted on the basis of a forty-hour week. If employed for at least the twenty (20) hours per week, and if this comprises the full time prescribed for the position, said part-time employees shall be credited with twelve (12) months membership service (i.e. Traffic Supervisors and School Lunch Employees).

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

All regular Permanent Employees who work at least thirty-five (35) or more hours per week shall be granted creditable service of twelve (12) months for each year of employment.

November 15, 1995

Amount of Creditable Service:

Part-time employees credit will be granted depending on the work history of the employee. Two categories of employment are considered as follows:

A. Employees in this category will have worked on a less than full-time basis throughout their years of service. For this category of employee, credit will be granted on the basis of one (1) year of credit for each year of service. The pension thus computed will be on an equitable basis as a full time employee. The deciding factor in the computation of the pension will be the three-year average earnings.

B. Employees in this category will have worked on both a full-time and part-time capacity during their years of service. In this category, credit for service will be computed on an individual basis. For the full-time service, the employee will receive one (1) year of credit for each year of service. For the part-time service, the employee will receive one (1) year of credit for two (2) years of part-time service. An alternate computation of creditable service will be made by using actual hours worked. This computation will be made using a ratio the dividend of which will represent the hours to be worked. The percentage thus computed will be that portion of a years of credit for the part-time work. Any interpretation of this paragraph shall be done on an individual basis by the Board.

April 24, 2000

Creditable Service [Non-elected] Board Members and Commissioners [who are compensated] will be granted membership, and if the salary is less that \$2500.00 annually, shall be credited with one year of creditable service for every three years of service rendered. Creditable service of one year shall be granted if the salary is more than \$2500.00 per year. This supplemental rule establishes rules for membership of compensated board members and commissioners in the City of Melrose and is consistent with the provisions of G.L. c. 32.

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by the Public Employee Retirement Administration Commission as of January 1, 2002.

The actuarial liability for active members was	\$34,806,933
The actuarial liability for retired and inactive members was	<u>42,316,231</u>
The total actuarial liability was	77,123,164
System assets as of that date were (actuarial value)	<u>50,134,256</u>
The unfunded actuarial liability was	<u>\$26,988,908</u>
The ratio of system's assets to total actuarial liability was	65.0%
As of that date the total covered employee payroll was	\$14,167,844

The normal cost for employees on that date was 7.70% of payroll

The normal cost for the employer was 8.10% of payroll

The principal actuarial assumptions used in the valuation are as follows:

Investment Return: 8.00% per annum
 Rate of Salary Increase: varies by service and job group

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2002

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Cov. Payroll ((b-a)/c)
1/1/2002	\$ 50,134,256	\$ 77,123,164	\$ 26,988,908	65.0%	\$ 14,167,844	190.5%
1/1/2000	\$ 45,357,277	\$ 68,098,788	\$ 22,741,511	66.6%	\$ 13,121,423	173.3%
1/1/1998	\$ 36,339,805	\$ 60,355,272	\$ 24,015,467	60.2%	\$ 11,802,022	203.5%

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2002

NOTE 6 - MEMBERSHIP EXHIBIT

Retirement in Past Years	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Superannuation	2	14	9	12	7	15	11	13	14	37
Ordinary Disability	0	1	0	0	0	0	1	0	1	2
Accidental Disability	3	1	0	3	0	2	0	1	2	2
Total Retirements	5	16	9	15	7	17	12	14	17	41
Total Retirees, Beneficiaries and Survivors	330	338	332	343	338	334	338	350	345	375
Total Active Members	393	386	397	399	417	412	432	401	425	420
Pension Payments										
Superannuation	\$1,810,338	\$1,915,609	\$2,009,902	\$2,074,874	\$2,189,676	\$2,200,358	\$2,397,883	\$2,661,603	\$2,794,186	\$3,095,286
Survivor/Beneficiary Payments	214,024	224,114	218,415	220,185	232,311	220,523	238,165	256,648	277,881	292,728
Ordinary Disability	97,226	101,197	107,482	101,757	111,436	130,458	134,834	73,424	111,275	126,690
Accidental Disability	431,867	464,297	457,192	532,247	529,698	534,588	534,805	610,545	590,154	618,896
Other	<u>104,416</u>	<u>102,484</u>	<u>118,223</u>	<u>186,504</u>	<u>201,344</u>	<u>197,954</u>	<u>211,412</u>	<u>231,850</u>	<u>240,364</u>	<u>277,974</u>
Total Payments for Year	<u>\$2,657,871</u>	<u>\$2,807,701</u>	<u>\$2,911,214</u>	<u>\$3,115,567</u>	<u>\$3,264,465</u>	<u>\$3,283,881</u>	<u>\$3,517,098</u>	<u>\$3,834,069</u>	<u>\$4,013,860</u>	<u>\$4,411,575</u>